

Prompt Corrective Action Guidelines

This document updates and incorporates all previous guidance issued by OTS on Prompt Corrective Action (PCA) into one single policy issuance. This document supersedes all previously issued guidance. The PCA statutory, regulatory, and policy framework provides OTS with effective supervisory remedies to minimize losses to the deposit insurance fund.¹

The statutory authority for PCA is found in the Federal Deposit Insurance Act (FDIA) at 12 USC 1831o. OTS has implemented that authority in regulations at 12 CFR Part 565. PCA requires that certain operating restrictions take effect when an institution is undercapitalized. The statute creates five capital categories, which are defined as follows by OTS at 12 CFR §565.4(b) (consistent with the other banking agencies):

PCA Categories

Thrifts fall into one of five PCA categories. The PCA minimum requirements are as follows:

	<u>Total Risk-Based</u>		<u>Tier 1/Risk-Based</u>		<u>Tier 1/Leverage</u>
Well Capitalized*	10% or greater	<i>and</i>	6% or greater	<i>and</i>	5% or greater
Adequately Capitalized	8% or greater	<i>and</i>	4% or greater	<i>and</i>	4% or greater (3% for 1-rated)
Undercapitalized	Less than 8%	<i>or</i>	Less than 4%	<i>or</i>	Less than 4% (except for 1-rated)
Significantly Undercapitalized	Less than 6%	<i>or</i>	Less than 3%	<i>or</i>	Less than 3%
Critically Undercapitalized	Has a ratio of tangible equity to total assets that is equal to or less than 2%. Tangible equity is defined in 12 CFR § 565.2(f) and differs from the definition of tangible capital under FIRREA.				

¹ OTS has additional powers under the Home Owners Loan Act (HOLA) for a thrift's failure to meet capital requirements as detailed in 12 CFR 567.10. This document does not discuss the HOLA capital provisions which are addressed in Thrift Activities Handbook Section 120 Capital Adequacy.

* To be well capitalized, a thrift also cannot be subject to a higher capital requirement imposed by OTS.

Notice of Capital Category and Mandatory and Discretionary Operating Restrictions

OTS deems that thrifts have received notice of their capital category as of the date they file a Thrift Financial Report (TFR) or when OTS transmits a final report of examination (ROE). A thrift must also notify OTS of any event that results in the lowering of a PCA capital category within 15 days of the material event that caused the decreased capital. 12 CFR §565.3(c)(2). In addition, OTS should provide written notice of a thrift's reclassified PCA status after receipt of a TFR, with the transmittal of a ROE, or upon learning of an event that results in a reclassification in capital category. The notice from OTS should include the mandatory and any discretionary operating restrictions (discussed below) applicable to thrifts in the designated category (see Chart 1 - PCA Categories). The restrictions are effective immediately upon the earlier of being deemed to have notice or receiving written notice of a capital category reclassification.

PCA requires OTS to apply progressively more significant restrictions on an institution's operations as its capital category falls. PCA mandates the imposition of two restrictions once a thrift falls below the well capitalized category. First, no thrift can make a capital distribution or pay certain management fees if it results in its becoming undercapitalized. Second, the FDIC restricts thrifts from receiving brokered deposits unless they meet the well capitalized definition. The remaining mandatory operating restrictions apply to institutions in the undercapitalized (or below) category.

For thrifts at the undercapitalized level and below, the additional mandatory operating restrictions include the following, found at 12 CFR § 565.6:

- Restricting capital distributions and certain management fees.
- Restricting asset growth.
- Limiting the ability to make acquisitions, branch, or enter new lines of business without prior agency approval.

- Compliance with a capital restoration plan submitted by the association.
- Requiring that OTS monitor the condition of the thrift.

All mandatory restrictions are effective immediately upon receiving or being deemed to have received notice of being less than well capitalized.

In addition to the mandatory restrictions, the PCA regulations provide OTS with authority to apply a wide range of discretionary remedies. Some of these provisions allow for directing changes in management should a thrift fall into the significantly undercapitalized level. OTS can mandate the election of a new board of directors, dismiss current directors and members of senior management, and require the hiring of certain qualified employees (subject to OTS approval) deemed necessary for safe and sound operations. 12 USC 1831o(f)(2)(F); 12 CFR §§ 565.6 and 565.9. Other discretionary remedies include restrictions or bans on certain types of lending, limits on bonuses, prior approval of certain contracts, and other restrictions that OTS deems appropriate.

If a thrift remains critically undercapitalized for ninety days, OTS must appoint a receiver or a conservator, or take such other action approved by the FDIC. (Capital failure as defined under the PCA statute is just one of the grounds for placing a thrift under a conservator or receiver.)

Even when thrifts are well capitalized or adequately capitalized under the PCA statute and regulations, OTS may exercise other authority to restrict a thrift's operations when capital levels are not commensurate with its balance sheet risk. OTS may use Individual Minimum Capital Requirements, Part 570 Compliance Plans, Supervisory Agreements, and/or Cease and Desist Orders .

Capital Restoration Plan

In addition to the mandatory and discretionary operating restrictions, the FDIA requires all thrifts below adequately capitalized to submit a capital restoration plan (Capital Plan) within forty-five days of their receiving notice or being deemed to

have notice of becoming undercapitalized. This section discusses the contents and approval of a Capital Plan in detail.

OTS regulations explain the timing, content, and approval standards for Capital Plans at 12 CFR § 565.5. The agency may alter the timing with proper cause.

Pursuant to agency policy, the Capital Plan must explain in detail the proposed strategy for becoming, at a minimum, adequately capitalized and for accomplishing the thrift's overall objectives. The plan should include:

- A detailed discussion of the following information:
 - The steps the association will take to become adequately capitalized, including underlying assumptions and proposed strategies.
 - Methodologies for forecasting the disposition of problem assets and the levels of expected charge-offs.
 - Any substantial changes in assets and liabilities.
 - The types and levels of activities in which the thrift plans to engage.
 - Strategies to control operating expenses, interest-rate risk, credit risk, and other significant risk exposures.
- Quarterly financial projections that generally follow the TFR, extending four quarters beyond the date the association becomes adequately capitalized. The projections should show the following information:
 - Progressively higher capital levels for complying with adequately capitalized standards.
 - Levels of core and net earnings.
 - Any capital infusions (specific steps must be taken within 6 months of becoming undercapitalized).

- Compliance with applicable statutory or regulatory restrictions and OTS policies.

The thrift must base its projections on the following realistic assumptions and rates:

- Current Treasury rates and the implied interest rate forecast embedded in the existing yield curve for Treasury securities, with spreads over Treasuries on incremental assets and liabilities consistent with prevailing market spreads.
 - Prepayment rates that reflect the market's consensus estimate for similar mortgage loans.
 - Loan origination rates using recent experience and taking into consideration current national and regional economic conditions.
 - The institution may use OTS's quarterly updates on interest rates. The thrift can request a copy from the OTS Regional Office shortly after each quarter-end.
- A standard form of guarantee and assurance from all controlling companies, as required under 12 USC 1831o. In a tiered holding company structure, each controlling company must provide a standard form of guarantee and assurance signed by a majority of the board of directors or a duly authorized official. The guarantee does not supersede any existing capital maintenance agreements. A copy of the standard form can be obtained from the Chief Counsel's Office.
 - A commitment in the Capital Plan to provide the Regional Director with quarterly variance reports comparing actual results to projected targets established in the capital plan within 30 days (or sooner if the institution drops another PCA Capital category) following the close of each calendar quarter. OTS will condition approval of the plan upon submission of these variance reports. Failure to file required variance reports may result in enforcement action including civil money penalties. Material variances are grounds for terminating a capital plan approval.

After receipt of the Capital Plan, OTS has sixty days to review the contents and decide whether to approve or deny. If the institution is critically undercapitalized, the FDIC will conduct a joint review of the proposed capital plan. By statute, 12 USC 1831o(e)(2), each agency must consider the following factors in determining whether to approve the plan:

- Does the Capital Plan specify the following information:
 - The steps proposed by the institution to become adequately capitalized, and the anticipated capital levels for each quarter contained in the plan.
 - How the institution will comply with the restrictions and requirements under the FDIA.
 - The types and levels of activities that the institution proposes to engage in, and such other information OTS may require.
- Has the institution based its capital plan on realistic assumptions and is it likely to succeed in restoring the institution's capital?
- Does the Capital Plan demonstrate that the plan will not appreciably increase the institution's exposure to risk (including credit, interest-rate, and other types of risk)?
- Does each controlling company of the undercapitalized institution:
 - Guarantee that the institution will comply with the plan until adequately capitalized (on average) during four consecutive quarters?
 - Provide appropriate assurances of performance?

PCA Directive

Whether or not OTS approves the Capital Plan, OTS regulations mandate issuing a directive to take prompt corrective action. 12 CFR §565.7 (PCA Directive).

If the Regional Director approves the Capital Plan submitted by the thrift then it becomes the basis for the PCA Directive along with any mandatory or discretionary operating restrictions applicable to the thrift (as discussed above). If the Regional Director determines that the thrift's Capital Plan is not acceptable or it fails to file one, the PCA Directive becomes the basis for imposing the mandatory and discretionary restrictions and directing the steps necessary to either increase capital to acceptable levels or otherwise move the thrift toward resolution.

The sequence for issuing the PCA Directive is as follows:

- Within fifteen days of reviewing and either approving or denying the thrift's Capital Plan, OTS will issue a "Notice of Intent to Issue a PCA Directive" providing the association with a copy of the proposed PCA Directive and allowing the association 14 calendar days to respond. OTS may shorten the 14-day period if the thrift's financial condition, or other circumstances, warrants.
- The notice of intent should state either that OTS is proposing to issue the directive in conjunction with approval of the Capital Plan, or that the institution has not submitted an acceptable Capital Plan under the standards of PCA. It should also state that OTS has issued the Directive to carry out the purpose of PCA to resolve the institution's problems at the least possible long-term loss to the deposit insurance fund.
- After reviewing the institution's response to the proposed PCA Directive, OTS should make any appropriate revisions.
- Within the fifteen days of issuing the Notice of Intent, OTS should provide the institution with the "Stipulation and Consent to the Issuance of a PCA Directive" for signature by the institution's board of directors.
- Upon receipt of an executed "Stipulation and Consent," OTS should then issue a final PCA Directive that requires compliance with the mandatory PCA sanctions and any discretionary PCA restrictions deemed appropriate.

OTS may issue an immediately effective PCA Directive even if the institution declines to execute the “Stipulation and Consent.” OTS can make the Directive effective upon issuance, or within a specified amount of time thereafter.

- In unusual circumstances, where immediate effectiveness of the PCA Directive is crucial, OTS may issue a PCA Directive without prior notice. To do so, OTS must document that immediate effectiveness is necessary to achieve the purpose of PCA. When we issue an immediately effective PCA Directive, the institution has 14 calendar days to submit a written appeal and OTS has 60 days to decide whether or not to modify the PCA Directive. The OTS’s PCA regulation permits shortening of the 14-day response period if the financial condition of the institution or other relevant circumstances warrants. The shortened period should allow sufficient time to make a meaningful response. 12 CFR § 565.7. OTS should document in the official file when it shortens the response period.

PCA Reclassifications

In certain situations, the statute allows OTS to reclassify an institution’s PCA category to a lower level.

OTS may reclassify a well-capitalized, adequately capitalized or undercapitalized institution to the next lower capital category and subject it to the restrictions applicable to that capital category if the OTS determines that the savings association is in an unsafe or unsound condition or engaged in an unsafe and unsound practice. 12 USC

1831o(g); 12 CFR § 565.8. Once OTS determines that a capital category reclassification is appropriate, all of the mandatory and any appropriate discretionary restrictions for that capital category apply to the institution.

Before reclassifying an institution’s PCA capital category, OTS must specify its grounds for doing so and serve the institution with a Notice of Intent to Reclassify. The Notice should include the following items:

- A statement of the institution’s capital measures and capital levels and the proposed reclassified category;
- The reasons for reclassification of the institution; and
- The date that the institution may file a written appeal of the proposed reclassification and a request for a hearing, which shall be at least 14 calendar days from the date of service of the notice unless OTS determines that a shorter period is appropriate in light of the financial condition of the savings association or other relevant circumstances.

An institution’s failure to file a written response with OTS within the prescribed timeframe shall constitute the institution’s consent to the reclassification. In the written response, an institution may request an informal hearing to present oral testimony or witnesses rebutting the reclassification. 12 CFR § 565.8(a)(5)(6). An institution that has been reclassified can petition OTS for a PCA category upgrade once it has successfully rectified the unsafe and unsound conditions.